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Agenda Item 7c

September 12, 2011

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. **SUBJECT:** Infrastructure Investment in California
- II. **PROGRAM:** Infrastructure
- III. **RECOMMENDATION:** Information
- IV. **ANALYSIS:**

At the presentation of staff's Infrastructure Strategic Plan (strategy) to the Investment Committee (Committee) in April 2011, Committee members indicated an interest in the subject of investment in infrastructure in California and accordingly, investment opportunities for CalPERS. To provide the Committee with information and an opportunity to discuss this subject, staff requested that the Board's Infrastructure Consultant, Meketa Investment Group (Meketa), prepare a report on California infrastructure investment. Meketa's presentation is provided as Attachment 1.

Meketa's report provides an assessment of the state of the infrastructure investment environment within California, noting the growing need for institutional investment to support public infrastructure, pointing out several conditions that have hindered such investment to date, and offering preliminary thoughts as to approaches that are needed and avenues that may be available to stimulate increased interest from institutional investors, including CalPERS. Given the sizable capital needs of California's state and local governments to support essential public infrastructure, governments will need to expand institutional funding sources beyond the tax exempt bond market, and attract substantial and sustained interest from broader and deeper pools of institutional capital.

Under the current government structure in the State of California, the process for identifying assets suitable for private sector partnering is complex and lengthy, with decision-making fragmented amongst various state agencies, authorities and local governments. In order to create a sustainable and efficient structure to meet California's long-term infrastructure funding needs, State government, working with expert advisors, should undertake the following initiatives: (1) establish clear objectives and policies around public infrastructure financing. Key

policies would address, among other things, issues such as revenue sources and approaches to partnering with private capital; (2) conduct a comprehensive, state-wide review of infrastructure needs; and (3) develop a streamlined and efficient process for identifying and reviewing assets across state and local agencies and sectors that have realizable value, or are otherwise suitable for procurement through partnerships with the private sector. Where appropriate, CalPERS should participate in these efforts.

Irrespective of current or future forms of the government's policy and framework, CalPERS has put in place the necessary foundation for the Infrastructure Program (Program) to initiate, review and invest in California-based infrastructure opportunities. Staff believes that in the near term, the vast majority of attractive, investible opportunities will continue to emanate from privately held and publicly listed investor-owned companies and organizations. Investment types which fall into this category and which are representative of the Program's current investment pipeline include power generation facilities, energy pipelines and storage, electric transmission, and utilities (energy and water).

Investment opportunities are reviewed by staff in the context of the Program's capital allocation, investment policy and strategy. The current target allocation is 2.0% of the Total Fund (three-year target of c. \$5.0 billion). Within the allocation, Infrastructure policy targets U.S. investment of 40% to 80% (c. \$2.0 to \$4.0 billion). Based on the policy, the Infrastructure strategy is a blueprint for investment execution, focusing on risk analysis and suitable portfolio construction. Pursuant to this, staff recommends an investment allocation for California of up to 20% of the U.S. portion of the Program. This would serve to provide a significant focus on California whilst maintaining geographic diversification in the portfolio and mitigating undue geographic concentration risk. The following table outlines the Program's targeted and maximum investment amounts based on the current allocation, policy and strategy:

Infrastructure Portfolio: 3-Year Time Horizon		
(\$ millions)	Portfolio Target	Portfolio Maximum
U.S.	3,000	4,000
*California	600	800
**No. of CA Transactions	2-4	2-5
* CA at 20% of U.S. portfolio target and maximum		
** Assumes average transaction size of \$150 - 300 million, consistent with Strategic Plan		

Staff is keen to explore with public sector agencies, districts and authorities across the U.S., and particularly within California, opportunities which meet the Program's investment requirements. These requirements are outlined in

Attachments 2 and 3 to this Item and are consistent with the approved strategy and policy, and the institutional market.

V. STRATEGIC PLAN:

This item supports the following strategic goals:

Goal VIII: Manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first to pay benefits and second, to minimize and stabilize contributions.

Goal IX: Achieve long-term, sustainable risk adjusted returns.

VI. RESULTS/COSTS:

There are no costs associated with this item.

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